

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 004407

SIPDIS

STATE FOR D, E, NEA/I, AND EB
STATE PASS TO USAID

E.O. 12958: DECL: 10/26/2015

TAGS: [ECON](#) [EFIN](#) [PGOV](#) [PREL](#) [MCAP](#) [IZ](#) [IMF](#)

SUBJECT: IMF DISCUSSIONS WITH IRAQ

Classified By: CHARGE D, AFFAIRES DAVID M. SATTERFIELD FOR REASONS 1.4 (B) AND (D).

1. (C) SUMMARY: GOI and IMF discussions in Amman on October 20-22 for a Standby Agreement (SBA) were successful. Although there are few quantitative targets, significant areas for reform have been set out. They include an emphasis on budgetary discipline; modest but required increases in fuel prices; and increased transparency in Central Bank operations. On October 26, the Council of Ministers (CoM) approved a letter accepting the SBA conditions, including fuel price increases. END SUMMARY.

General Budget Discussions

2. (C) On October 25, U.S. and UK Embassy staffs received a joint briefing on results of GOI Ministry of Finance (MOF) discussions held with the IMF in Amman from October 20-22. The Iraqi briefer was MOF Chief of Staff Musab al-Khateeb, a participant in the SBA discussions and confidant of Minister of Finance Allawi. Al-Khateeb confirmed that discussions had produced agreement on a Letter of Intent (LOI) for a Standby Arrangement (SBA). Although the agreement will be for one year, two renewals of one year each are possible. Four reviews are anticipated for 2006, with a fifth in spring 2007.

3. (C) Main points of conditionality include: 1) concurrence by the IMF with an approved state budget; 2) fuel price increases; and 3) significant progress toward a transparent audit of the Central Bank of Iraq. Quantitative targets for the overall deficit, wages, and pensions were suggested in the discussions, but al-Khateeb observed that they are for the most part bracketed. Importantly for revenue projections, the parties accepted a baseline oil production number of 1.7 million barrels per day (mbpd) priced at an average \$46.6 per barrel. This yields a working number of \$29.9 billion for petroleum-based revenue in 2006, or \$27.5 billion after allowing for 5 percent reparations to Kuwait.

4. (C) While there appear to be few quantitative targets in the LOI, al-Khateeb stated that the IMF wishes to see the 2006 deficit limited to 5.3 trillion ID (\$3.6 billion), compared to the deficit of \$5.0 billion that appeared in MOF's earlier draft budget. The IMF also suggested a limit to wages and pensions of 9.3 trillion ID (\$6.2 billion), not including the security ministries. Regarding the former, Allawi reportedly did not agree and said that it may increase and be covered by a 2005 carry-over. The IMF was troubled by a GOI plan to introduce pensions for civil servants at 80 percent of salary, an initiative that Minister Allawi claimed had been discarded. Responding to an IMF suggestion that targeted assistance to the poor be provided, about \$333 million will be set aside for this purpose. The IMF also proposed introduction of a sales tax and value-added tax, although no rates were mentioned. The IMF expressed concerns on the security budget. The planned budgets for MoD and MoI total \$5.3 billion, which the IMF is watching carefully.

5. (C) The IMF wants to review the budget before it is submitted to the CoM. (COMMENT: According to our Iraqi source, the SBA will not hinge on budget approval by the TNA, although review and passage by that body would be desirable. If true, this provides a tremendous opportunity to the GOI, since it needs to fulfill terms of the SBA in order to proceed with Paris Club debt forgiveness and rescheduling. END COMMENT.)

Fuel Subsidies

6. (C) The fuel subsidy issue received particular attention, with Minister Allawi enjoined to secure a commitment from the current government to increase prices of all fuels, effective December 16 (i.e., the day after scheduled national elections). The price increases should include the following changes (strictly protect):

- a) Regular gasoline: 20 ID per liter to 75 ID
- b) Premium gasoline: 50 ID per liter to 150 ID
- c) Kerosene: 5 ID per liter to 25 ID (by March 2006).

-d) Diesel: 10 ID per liter to 20 ID (private consumers)

(NOTE: These prices fall far short of current black market levels. However, they basically track those prices already approved by the CoM to be introduced December 31. END NOTE.)

17. (C) Approaching the fuel subsidy problem from an angle that eventually could permit sale of imported fuels and petroleum products at market prices, the IMF has requested that the recent CoM action liberalizing fuel imports be submitted to the TNA, with the Minister of Oil also given authority to change prices as part of the law. The IMF has stressed the importance of the government's commitment to increase fuel prices. That message has been received, since as al-Khateeb noted, "if it does not go into effect, there will be no SBA."

Introducing Transparency into the Central Bank

18. (C) Considerable attention was paid to measures to increase transparency and effectiveness of the Central Bank of Iraq (CBI). Accordingly, conditions for the SBA include significant progress in the international audit of the CBI. The SBA also will quantify net national reserves as well as set targets for the CBI with specific performance dates.

Process

19. (C) Next steps should include approval of the LOI by the IMF board and then by the Council of Ministers. Other preliminary conditions include:

--Approval of the 2006 budget by the Council of Ministers;
--TNA approval of legislation liberalizing the oil product import regime; and
--Implementation of price changes for refined petroleum products sold in the domestic market.

Comment

19. (C) COMMENT: Although there are elements that still need clarification, it seems that the GOI has come off well in this discussion with the IMF. The door is open for the SBA, the essential benchmark for Iraq to make further progress with its international creditors. However, the ball is in Allawi's court to produce a budget that meets the IMF's concerns over limiting the deficit and implementing fuel price increases. In this context, al-Khateeb's observation that the number of people in the government who see the benefit of the SBA is increasing is reassuring. END COMMENT.
Satterfield